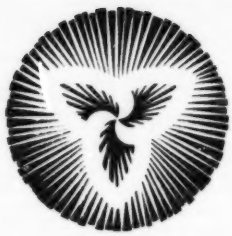

ONTARIO ENERGY CORPORATION

Annual Report 1986

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THE YEAR'S HIGHLIGHTS

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PRESIDENT'S REPORT

In 1985, the Government of Ontario decided to begin divesting its energy portfolio for cash. This decision has required disposing of the Corporation's assets professionally and prudently. It has also required the application of careful stewardship and sound business acumen, to maintain asset values and obtain the best cash value possible from the sales.

Between late November 1985 and the spring of 1986, crude oil prices plunged from just over $30 U.S. per barrel to the $12 to $15 level. These developments represented the sharpest price drops since 1979, and made 1986 a difficult year for the energy industry.

Despite the industry-wide downturn, the Corporation continued to honour its obligations and commitments to its partners, both in the conventional areas and in frontier exploration in the Beaufort Sea, Mackenzie Delta and east coast offshore.

On June 19, 1986, a new Board of Directors was appointed to carry out this divestiture mandate. The Corporation's full-time staff was terminated in September 1986, and a new team, consisting of the Board of Directors, Officers, and management staff drawn from the Ontario ministries of Energy, Treasury and Economics, and from the Management Board of Cabinet, began implementing the government's strategy.

Sales of the Corporation's conventional oil and gas properties and energy technology investments totalled $2.6 million by the end of 1986. Negotiations for the sale of the remaining properties were under way.

Subsequent to the end of the fiscal year, the Corporation has sold or accepted offers to purchase its western Canadian petroleum interests in joint ventures with Triweb Resources Ltd. and Mannville Oil and Gas Ltd., for a total of $11.0 million in cash.

Negotiations were also under way for the cash sale of Onexco's two-thirds interest in Trillium Exploration Corporation's frontier properties. Simultaneously, negotiations were progressing for the cash sale of some of the assets of Ontario Energy Ventures Limited. In addition, the Corporation completed its commitment to and terminated its participation in the Polar Gas Project.

The Corporation's income from production net of operating costs and royalties amounted to $2.9 million, and interest income amounted to $0.9 million. General and administrative expenses, including costs associated with the Corporation's wind-down, were $1.7 million, while depreciation and depletion expenses totalled $2.9 million. The loss from operations was $0.8 million (compared to income of $1.6 million in 1985) before write-down and equity adjustment.

The Corporation reported a loss for 1986 of $36.4 million largely because of write-downs and equity adjustments, compared to a loss of $93.6 million in 1985. As was common within the industry during the year, the Corporation wrote down a number of its investments, to reflect the sharp decline in crude oil prices.

In the coming months, the Corporation anticipates successfully completing the government's directive to dispose of its remaining assets.

I want to acknowledge and pay tribute to the professionalism of the Corporation's Board members, officers, and management staff. Their talent, dedication and hard work have effectively guided the Corporation through a very difficult period. I would also like to acknowledge the contribution of the former President, Board of Directors, and administration to the Corporation.

Respectfully submitted on behalf of the Board:

Duncan M. Allan
President and Chief Executive Officer

BOARD OF DIRECTORS

Duncan M. Allan
Deputy Minister
Ministry of Energy

I. Bruce MacOdrum
Assistant Deputy Minister
Ministry of Energy

Roger M. R. Higgin *
Assistant Deputy Minister
Ministry of Energy

George A. Dominy
Manager, Finance, Rates and Utilization
Ministry of Energy

Donald S. McColl *
Assistant Deputy Minister
Ministry of Treasury and Economics

Robert A. Simpson *
Assistant Secretary
Management Board of Cabinet

* Member of Audit Committee

OFFICERS

Duncan M. Allan
Chairman
President and Chief Executive Officer

Victor A. Bailey *
Treasurer

Robert Law
Secretary

* As of October 1, 1986, replacing Glen C. Francis

AUDITORS

Deloitte Haskins & Sells
Toronto, Canada

ONEXCO OIL AND GAS LTD. (ONEXCO)

In 1986, Onexco Oil and Gas Ltd. participated in 44 exploratory and development wells in Ontario, Western Canada, and, through Trillium Exploration Corporation, in Canada's frontier regions.

Oil production averaged 615 barrels per day for the year, a significant increase over average 1985 production of 360 barrels per day. Production for December averaged 903 barrels per day, excluding interests sold during the course of 1986. Natural gas production averaged 510,000 cubic feet per day, up from 239,700 cubic feet per day in 1985. Production in December was 710,000 cubic feet per day.

Revenue for 1986 was $4.3 million, a decrease from 1985's $4.9 million. Exploration expenditures during 1986 were $8.4 million compared to $21.0 million in 1985. Expenditures were financed by internally generated cash flow, PIP grants and loans from the Ontario Energy Corporation.

Ontario Conventional Joint Ventures

Onexco has sold its interests in two Ontario joint ventures: one operated by the Consumers' Gas Company, with participation by Pembina Resources Ltd. (in a limited area), the second operated by Canadian Occidental Petroleum Ltd., with Petro-Canada as a partner.

During 1986, up to the point of sale, the Consumers' Gas joint venture drilled four wells, one of which was commercially successful. The Canadian Occidental/Petro-Canada joint venture did not undertake any drilling in 1986. Onexco's share of production from the Ontario properties averaged 127 barrels of oil per day.

Onexco's interest in both ventures was purchased by Devran Petroleum Ltd. on October 2, 1986, for $1.7 million. An independent evaluation by the Corporation's financial advisors confirms this to be fair market value.

Western Canada Conventional Joint Ventures

Onexco has two joint ventures in Western Canada: one with Triweb Resources Ltd., and another with Mannville Oil and Gas Ltd. Over the year, 26 exploratory and development wells were drilled, with eight completed as oil discoveries, and three as natural gas discoveries.

Production to Onexco's account from the two joint ventures averaged 488 barrels of oil per day and 510,000 cubic feet of natural gas per day. Year-end production was 903 barrels of oil and 710,000 cubic feet of natural gas per day.

Negotiations are currently in progress for the sale of these interests.

Frontier Joint Ventures

Trillium Exploration Corporation

Trillium was formed in 1982 by Onexco Oil and Gas Ltd. (66.67 per cent) and Suncor Inc. (33.33 per cent) to explore Canada's frontier regions. During 1986, Trillium participated in 14 exploratory and delineation wells with eight discoveries. Since 1982, Trillium has participated in 59 wells, with 30 considered to be discoveries. Trillium has an interest in 45,040,029 acres (7,222,424 acres net) located in the major frontier areas.

Cash call advances of $17.1 million were offset by PIP grant recoveries of $23.9 million, thus reducing total advances by $6.8 million to $40.6 million in 1986.

During 1986, Onexco and Trillium fulfilled ongoing obligations to other joint venture partners.

Onexco has informed its minority partner of its intention to divest the Company's interest in Trillium in the near future.

ONTARIO ENERGY RESOURCES LTD. (OERL)

Ontario Energy Resources Ltd. is a wholly-owned subsidiary of the Corporation which retains the Ontario government's 25 per cent equity interest in Suncor Inc.

Suncor Inc. reported a net loss for the year of $7.0 million, compared to net income of $22.0 million for 1985.

Earnings from operations in 1986 were $1.0 million, compared to $34.0 million in 1985.

In 1986, lower crude oil prices resulted in a severe reduction in Suncor Inc. cash generation. Earnings from the resources and oil sands groups were significantly affected. In addition, poor margins were experienced in the company's downstream business activities.

With improved margins resulting from substantial productivity increases, Suncor Inc. earnings showed a turnaround in the latter half of the year. Despite these changes, however, the overall financial performance for the year remained disappointing.

The 1986 Suncor Inc. cash dividend to the Corporation was $3.9 million, compared with $10.4 million in 1985. Third - and fourth-quarter dividends were paid in stock.

ONEXCO MINERALS LTD.

Onexco Minerals Ltd. is a wholly-owned subsidiary in lignite exploration in Ontario. The Company held a Licence of Occupation on 150,000 acres in the James Bay lowlands region of northeastern Ontario which was terminated in September 1986.

While the Company was an active, successful explorer over the 1982-1983 period, economic conditions caused field activities to cease in 1984. In 1985, all capitalized exploration costs were written off.

The Company has applied for formal dissolution of its charter.

ONTARIO ENERGY VENTURES LIMITED (OEV)

OEV is the Corporation's venture capital subsidiary with investments in energy from waste, energy management, enhanced oil recovery, oil substitution and transportation technologies.

In keeping with the Corporation's wind-down mandate, OEV sold four investments from its portfolio during 1986. At year end, the Corporation retained eleven investments with private sector firms.

Of these remaining investments all are at various stages of negotiation or liquidation/wind up. In all cases, OEV is seeking prudent divestment opportunities with the objective to facilitate the ongoing viability of the venture where possible. While OEV's existing venture partners are given first opportunity to buy OEV's interest, in some cases, third parties have been required to provide necessary financing.

Subsequent to year end, OEV has successfully divested one additional investment and has reached agreement in principle with two others. It is expected that OEV's investment portfolio will be fully divested during 1987.

FINANCIAL STATEMENTS

PREPARATION AND REVIEW OF THE FINANCIAL STATEMENTS

The financial statements have been prepared by management in accordance with generally accepted accounting principles. Management is also responsible for the other information in the annual report, which is consistent with that contained in the financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through an Audit Committee of the Board, which is composed of directors who are not employees of the Corporation. The Audit Committee meets with management and the external auditors at least twice each year to satisfy itself that management's responsibilities are being properly discharged and to review annually the financial statements.

The external auditors, Deloitte Haskins & Sells, conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the Corporation's financial statements. The auditors' examination includes a review and evaluation of the Corporation's system of internal control. Appropriate tests and other procedures are conducted to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board. The Provincial Auditor has access and reviews from time to time the working paper files of the external auditors.

AUDITORS' REPORT

TO THE SHAREHOLDER OF ONTARIO ENERGY CORPORATION

We have examined the consolidated balance sheet of Ontario Energy Corporation as at December 31, 1986 and the consolidated statements of loss and deficit and of changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year, as restated.

Deloitte Haskins & Sells

Chartered Accountants
Toronto, Canada
June 10, 1987

CONSOLIDATED STATEMENT OF LOSS AND DEFICIT

Year ended December 31, 1986

	1986	1985 (restated-Note 5)
	(000's)	
REVENUE		
Interest	$ 893	$ 1,451
Production	4,279	4,944
	5,172	6,395
EXPENSES		
Depreciation and depletion	2,888	1,795
General and administrative	1,648	1,724
Production, operating and royalties	1,425	1,249
	5,961	4,768
(LOSS) INCOME FROM OPERATIONS	(789)	1,627
WRITE-DOWN AND DISPOSAL OF INVESTMENTS (Note 3)	(33,306)	(85,695)
EQUITY ADJUSTMENT IN INVESTMENTS (Note 4)	(2,279)	(9,580)
LOSS	(36,374)	(93,648)
(DEFICIT) RETAINED EARNINGS, BEGINNING OF YEAR:		
As previously reported	(59,335)	42,313
Suncor Inc. adjustment (Note 5)	(19,500)	(27,500)
As restated	(78,835)	14,813
DEFICIT, END OF YEAR	$(115,209)	$ (78,835)

CONSOLIDATED BALANCE SHEET

December 31, 1986

Assets		
CURRENT ASSETS		
Cash and short-term investments	$ 12,540	$ 5,425
Accounts receivable	851	4,350
	13,391	9,775
INVESTMENTS (Note 2)		
Suncor Inc.	263,332	269,250
Trillium Exploration Corporation	20,287	47,391
Energy resource ventures	10,913	20,968
Energy technology ventures	1,109	4,265
	295,641	341,874
FIXED ASSETS	8	39
	$ 309,040	$ 351,688
Liabilities		
CURRENT LIABILITIES		
Accounts payable and accrued charges	$ 453	$ 258
Short-term borrowings	1,081	7,550
	1,534	7,808
Shareholder's Equity		
SHARE CAPITAL (Note 6)	97,715	97,715
CONTRIBUTED SURPLUS	325,000	325,000
DEFICIT	(115,209)	(78,835)
	307,506	343,880
	$ 309,040	$ 351,688

Approved by the Board:

Duncan M. Allan, Director

Roger M. R. Higgin, Director

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year ended December 31, 1986

	1986	1985 (restated-Note 5)
	(000's)	
OPERATING ACTIVITIES		
Loss	$ (36,374)	(93,648)
Suncor Inc. dividends	3,918	10,449
	(32,456)	(83,199)
Items not affecting cash flow		
Depreciation and depletion	2,888	1,796
Amortization-Suncor Inc.	-	14,380
Equity in earnings of investments	2,279	(4,800)
Write-down and disposal of investments	33,306	85,695
Other	(14)	19
	6,003	13,891
Changes in operating working capital		
Accounts receivable	3,499	(2,789)
Accounts payable and accrued charges	196	29
Cash provided by operating activities	9,698	11,131
INVESTING ACTIVITIES		
Trillium Exploration Corporation	(17,062)	(30,850)
Energy resource ventures	(5,918)	(18,606)
Petroleum Incentives Program Grants	24,583	28,325
Energy technology ventures	(299)	(1,297)
Proceeds on sale of investments	2,582	-
Polar Gas Project	-	(921)
Cash provided (used) by investing activities	3,886	(23,349)
FINANCING ACTIVITIES		
Government assistance	-	265,465
Reduction in long-term debt	-	(276,250)
Issue of common shares	-	15,844
Short-term borrowings	(6,469)	7,550
Cash (used) provided by financing activities	(6,469)	12,609
INCREASE IN CASH	7,115	391
CASH AND SHORT-TERM INVESTMENTS, BEGINNING OF YEAR	5,425	5,034
CASH AND SHORT-TERM INVESTMENTS, END OF YEAR	$ 12,540	$ 5,425

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1986

1. SIGNIFICANT ACCOUNTING POLICIES

Ontario Energy has invested in, or otherwise participated in, energy projects with a view to enhancing the availability of energy in Ontario. It has determined to seek prudent disposal of its investments.

Basis of financial statement presentation

The consolidated financial statements include the accounts of the Ontario Energy Corporation and its subsidiaries except Trillium Exploration Corporation ("Trillium"). The Corporation's involvement in Trillium is in a financing rather than an operating role. Accordingly, consolidating the accounts would not be more informative.

The investment in Suncor Inc. and certain other investments are accounted for using the equity method.

The full-cost method of accounting is used to account for the Corporation's direct investments in oil and gas exploration activities whereby all costs of exploring for and developing oil and gas reserves are capitalized.

Fixed assets

Furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is determined using the straight-line method over a period of 60 months.

Income taxes

The Corporation and its wholly-owned direct subsidiaries and their wholly-owned direct subsidiaries are not subject to income tax so long as not less than 90 per cent of the outstanding shares of the Corporation are held directly by the Province of Ontario. All of the Corporation's outstanding shares are presently held by the Province of Ontario. Onexco Oil & Gas Ltd., which is a wholly-owned indirect subsidiary of the Corporation, is subject to income taxes.

2. INVESTMENTS

Suncor Inc.

The investment in 25% of the shares of Suncor Inc. is accounted for using the equity method.

2. INVESTMENTS (continued)

Summarized financial information of Suncor Inc. as at December 31 is as follows:

	1986	1985 (restated-Note 5))
	(millions)	
FINANCIAL INFORMATION		
Working capital	$ 74	$ 87
Total assets	$ 2,107	$ 2,251
Shareholders' equity		
Preferred shares	$ 7	$ 9
Common shares and retained earnings	1,053	1,077
	$ 1,060	$ 1,086
Operations		
Revenue	$ 1,157	$ 1,474
(Loss) net income	$ (7)	$ 22
Cash dividends on common shares	$ 16	$ 42
Stock dividends on common shares	10	-
	$ 26	$ 42

In 1985 certain companies instituted an action against Suncor Inc. disputing their obligation to pay an overriding royalty to Suncor. The amount of disputed royalty revenues recorded by Suncor to December 31, 1986 is approximately $23 million before taxes, including $3 million in 1986. Any material adverse financial impact on Suncor Inc. resulting from this action will be applied retroactively to the periods affected.

Trillium Exploration Corporation

The Corporation has a two-thirds interest in Trillium, which was formed to explore for oil and gas in the frontier areas of Canada. Trillium has had no income or loss from operations. The shareholders of Trillium have decided to scale down its activities beginning June 30, 1987.

At December 31, 1985, the net advances to Trillium amounted to $47,390,462. During 1986, this amount was reduced by $6,815,360, representing the excess of Petroleum Incentive Program (PIP) Grants received over advances. Due to the uncertainty with respect to future development in the frontier areas, the Corporation has decided to write down the carrying value of its investment in Trillium by 50% to $20,287,551.

The Corporation has outstanding commitments to Trillium for exploration activities in 1987 of approximately $22.5 million which will be reduced by PIP Grants of approximately $19.9 million.

2. INVESTMENTS (continued)

Energy resource ventures

Subsequent to the year end, the Corporation sold or accepted purchase offers for its conventional energy resource ventures for cash of $11 million, which approximates the year end carrying value.

Energy technology ventures

The Corporation has investments in energy technology ventures of various types, typically in the form of a minority equity interest or debt. These investments are reflected at the lower of cost and estimated net realizable value.

3. WRITE-DOWN AND DISPOSAL OF INVESTMENTS

In accordance with its divestiture policy, the Corporation has sold or written-down certain investments.

	(000's)
Trillium Exploration Corporation	$ 20,288
Energy resource ventures	10,503
Energy technology ventures	2,515
	$ 33,306

4. EQUITY ADJUSTMENT IN INVESTMENTS

Equity adjustment in investments reflects the Corporation's share of the income or loss of Suncor Inc. and certain energy ventures which investments are accounted for using the equity method.

5. SUNCOR INC. ADJUSTMENTS

(a) Successful Efforts Accounting

The Corporation's opening retained earnings for 1986 and 1985 have been restated to reflect a change in accounting policy adopted by Suncor Inc. During 1986, Suncor Inc. retroactively adopted the successful efforts method of accounting for its crude oil and natural gas operations. Previously Suncor Inc. had followed the full cost method.

The accounts of the Corporation have been restated to reflect the effect of this change by Suncor Inc., to the extent of its 25% interest therein, by increasing the 1986 opening deficit by $22.75 million, decreasing the 1985 equity adjustment and loss for the year by $8 million and decreasing the 1985 opening retained earnings by $30.75 million.

(b) Norcen Litigation

During 1986, the Alberta Court of Appeal held that Suncor Inc. need not pay disputed sublease royalties to Norcen International Ltd. relating to periods prior to July 1982. The financial impact of the judgement has been reflected retroactively in the periods affected. Accordingly, the Corporation's opening 1986 deficit was decreased and the 1985 opening retained earnings was increased by $3.25 million.

6. SHARE CAPITAL

Share capital - December 31, 1986 and 1985	
Authorized	(000's)
An unlimited number of common shares	
20,000,000 non-voting special shares	
Issued	
2,000,000 common shares	$ 100,000
Less	
45,708 common shares held in Treasury, at cost	2,285
	$ 97,715

7. STATEMENT OF CHANGES IN FINANCIAL POSITION

The 1986 statement of changes in financial position focuses on changes in cash. The 1985 figures, which were originally presented on a working capital basis, have been restated to conform to the 1986 presentation.